



United States Department of Agriculture  
Rural Development  
Montana State Office

May 2, 2006

**MT AN No. 257  
(1980-D & 3550)**

**TO:** All Rural Development Area Offices  
USDA, Rural Development, Montana

**SUBJECT:** 2-1 Buy-Down Utilization with both the 502 Direct and Guaranteed  
Loan Programs

**PURPOSE/INTENDED OUTCOME:**

This Administrative Notice (AN) provides guidance in structuring and utilizing 2-1 Buy-Down programs with USDA Rural Development Section 502 Direct and Guaranteed Loan Programs.

**COMPARISON WITH PREVIOUS AN:**

This AN replaces MT AN 234.

**BACKGROUND AND PROGRAM EXPLANATION**

Frequent questions are asked relative to the 2-1 Buy-Down programs available throughout the mortgage industry. The program indicates that for the first year of the mortgage the starting rate will be 2% less than the note rate. During the second year of the mortgage the rate will be 1% less than the note rate, thus graduating the payment up 1% per year for the first 3 years. For example, the note rate is 6.25%. The first year payments will be based on a rate of 4.25%. The second year payments will be based on a rate of 5.25%. And the third through thirty year payments will be at the full note rate of 6.25%.

These types of Buy-Down programs allow the borrower to qualify at the starting rate and are often utilized where the borrower can't qualify at the full note rate.

**EXPIRATION DATE:**  
May 2, 2007

**FILING INSTRUCTIONS:**  
HB-1-3550 Appendix 7 and  
Preceding MT Inst. 1980-D

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Normally, the seller or lender will pay the cost of the buy-down (difference in the payments for the first 2 years of the loan). If the seller pays, the purchase price is usually increased in an amount equal to the buy down-cost, and the costs are disclosed on the HUD-1 as a seller paid fee. If the lender pays, the costs are built into the pricing discount (retail rate vs. wholesale rate).

## **IMPLEMENTATION RESPONSIBILITIES:**

Both RD Instructions 1980-D and 3550 allow for participation with Buy-Down programs. They don't specifically identify the 2-1 Buy-Down, however they both cap the interest rate buy-down at 2%. Both instructional languages are similar and require adherence to the following restrictions.

- 1) Maximum buy-down is 2%.
- 2) Utilization of buy-downs requires prior RHS approval.
- 3) The buy-down costs must be paid by a party other than the borrower.
- 4) The lender must provide compensating factors which indicate the borrower's ability to meet the expected increases in loan payment.
- 5) Interest rates can't increase more than 1% per year.

These programs are designed to assist people in obtaining home ownership when they can't qualify at current market rates due to income levels. The loans will adjust to full market rates in 3 years, so there has to be a very strong indicator that the borrower's income will increase by an amount equal to the required income to qualify at the full note rate. Some examples might be an individual currently in an apprentice position expecting to move to a journeyman position, or a new school teacher on a graduated salary contract.

2-1 Buy-Down loans should not be approved for applicants that have risk layering. These applications will require Housing Program Director approval.

Please contact Deborah Chorlton, Housing Program Director, at 406-585-2551 with any questions.

W.T. (Tim) RYAN  
State Director